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Supreme Court, U.S.
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No. 96-1938

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1996

IN RE: BAKER & GETTY FINANCIAL SERVICES, INC.,
Debtor,

WESBANCO BANK BARNESVILLE,
formerly known as The First National Bank of Barnesville,
Petitioner,

v.

CARL D. RAFOTH, Trustee
CUSTOMER CREDITORS,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

REPLY BRIEF OF THE PETITIONER IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

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ARGUMENT

I. THERE ARE COMPELLING REASONS FOR THIS COURT TO GRANT THE PETITION FOR A WRIT OF CERTIORARI.

WesBanco, by and through counsel, is filing this Reply Brief in response to the Respondents' Brief in Opposition to the Petition for Writ of Certiorari. WesBanco will limit this Reply Brief to addressing the misstatements of both law and fact which are contained in the Respondents' Brief in Opposition.

The Respondents have asserted that the argument set forth by WesBanco in its Petition does not satisfy Rule 10 of the Supreme Court Rules which mandate the presence of a compelling reason for the granting of a Petition for Writ of Certiorari. Contrary to the Respondents' statement, this case does present compelling reasons for granting the Writ. If the lower courts' decision to liquidate this estate as a stockbroker liquidation is allowed, it will represent the first and only time that a stockbroker liquidation has been ordered in a bankruptcy estate where the debtor admittedly was never engaged in even a single securities transaction. Contrary to the Respondents' statements, this Petition does not simply present a "fact-bound application of well-established law". If that was the case, the Respondents should have cited their authority. The case instead presents a case of first impression, since no court has ever ordered a stockbroker liquidation where a debtor did not utilize assets provided to it for even a single securities transaction. Clearly, there are compelling reasons to grant the requested Writ.

II. THE RESPONDENTS HAVE MISSTATED THE FACTS RELATING TO THE ROLE PLAYED BY MUTUAL SERVICES.

As the Respondents acknowledge, for an entity to be considered a stockbroker under bankruptcy law, the entity must satisfy the two-part test set forth in 11 U.S.C. § 101(53A). The debtor must have customers as that term is statutorily defined, and secondly, the debtor must be engaged in the business of effecting transactions in securities.

The only individuals who satisfy the customer definition in the underlying bankruptcy estate are the Respondents. They are the only individuals who deposited cash or other property with Cordek or B&G. As such, they are the only individuals who have a claim against the debtors in this case. 11 U.S.C. § 101(53A) thereafter provides that in considering whether an entity is a stockbroker, the court must analyze the definition "with respect to which there is a customer". With respect to the Respondents, who are the only customers of Cordek and B&G, there is admittedly no evidence which indicates that B&G utilized these funds for the purpose of engaging in the business of effecting transactions in securities.

Cordek in his deposition testimony acknowledged that no stock was ever purchased from the funds provided by the Respondents. (R. 1, Cordek Dep. 47-49.) The Trustee also openly acknowledged that with respect to the funds provided by the Respondents, B&G never utilized the funds for engaging in a securities transaction.

Knowing that the funds provided by the Respondents were never utilized for effecting a securities transaction as the statute required, the Respondents obviously had to look elsewhere. As a result, the Respondents diverted the lower courts' attention to the activities undertaken by David Perham and Daniel Schwenker with a separate brokerage firm, Mutual

Services. The Respondents in their Brief in Opposition have repeatedly referred to Mutual Services as a "clearinghouse" which was simply utilized to conduct trades on behalf of B&G. (Respondents' Brief at 17-18.) The Respondents' attempt to characterize Mutual Services as merely a "clearinghouse" is a clear misstatement of fact and directly contradicts the actual testimony of David Perham, whom the Respondents called to provide testimony at the bankruptcy hearing. Mr. Perham testified as follows:

> Q. And what did you do through Mutual Services?
>
> A. Through Mutual Services, I enacted stock transactions for various clients...
>
> Q. Let me have the Judge hand you Exhibit 2 and can you identify what this is?
>
> A. This is a statement, the clearing house is Mezzrow and Company, the broker/dealer is Mutual Services...

(R. 1, 9/28/94, Tr. 25.) (Emphasis added.)

While a clearinghouse (Mezzrow and Company) may have been used, the clearinghouse was not Mutual Services. Perham described the role that Mutual Services was asked to serve:

> Q. You also indicated that the purpose for Mutual Service Corporation was to, in fact, effect the transactions in securities?
>
> A. Yes.
>
> * * *

Q. And you - you effected transactions as a licensed representative through Mutual Service?

A. Correct.

(R. 1, 9/28/94, Tr. 39-40.) (Emphasis added.)

Even the Respondents' main witness testified that Mutual Services was not a clearinghouse. Mutual Services admittedly was the broker which was utilized to effect transactions in securities because B&G was unable to do so.

The testimony of Daniel Schwenker furthermore demonstrates that the investors who purchased securities through Mutual Services were in fact customers of Mutual Services and not Baker & Getty.

Q. And the remittances were paid directly to Mutual Services?

A. Yes. Oh, yes. All my clients - any transactions that take place, if there is not money in the account, the client makes out a check directly to the broker-dealer and not out to Baker & Getty.

(R. 1, Schwenker Dep. 45-46.) (Emphasis added.)

The efforts by the Respondents to characterize Mutual Services as a clearinghouse is simply a misstatement of the facts. As WesBanco has maintained throughout, this case involves two separate and distinct entities who dealt with differing individuals. The Respondents, who are the creditors of this case, provided funds directly to Cordek or B&G. These funds were utilized to further Cordek's Ponzi scheme,

and admittedly none of the funds were used for the purchase of securities.

The second group involves the individuals who purchased securities through Mutual Services, which was a legitimate brokerage firm. This firm had no affiliation with either Cordek or B&G. These individuals provided funds directly to Mutual Services and Mutual Services in turn purchased securities on their behalf. These securities, however, have never been assets of this bankruptcy estate, nor have the Mutual Services' customers ever been creditors of this estate.

If, in fact, Mutual Services was simply a clearinghouse for B&G as the Respondents would like this court to believe, then the securities purchased through Mutual Services should have been held by B&G and the accounts for these individuals should have been maintained by B&G. These assets would then have been available for distribution in this bankruptcy estate. However, the securities purchased by the customers of Mutual Services have no relationship to this estate. As a result, the trustee has never considered Mutual Services' customers as creditors of this estate nor has he considered the securities purchased by Mutual Services as assets of the bankruptcy estate.

III. THE APPROPRIATE INQUIRY WHICH MUST BE MADE IS TO LOOK TO WHAT THE DEBTORS ACTUALLY DID AS OPPOSED TO FOCUSING ON THE PERCEPTION THE DEBTORS SOUGHT TO CREATE.

An additional underlying theme of the Respondents' Brief is that B&G satisfies the stockbroker definition found in 11 U.S.C. § 101(53A) since they created a perception to the general public that they were a full service brokerage firm. The Respondents devote several pages of their Brief to

demonstrate the elaborate efforts which were undertaken by B&G to create this mistaken impression. (Respondents' Brief at 4-7.) The issue, however, does not turn on what perception may have been created, but instead should turn on the actual conduct of the debtors in this case. The testimony relating to the conduct of the debtors demonstrates that at no time were any funds deposited by any of the Respondents with B&G or Cordek ever utilized for the purchase of a single security.

The Respondents have attempted to distinguish the cases cited by WesBanco in its initial Petition which hold that the court should look to the activities of the debtor, and not merely the perception which an individual may have had. For example, the Respondents have tried to distinguish the holding in *In re Brentwood Securities, Inc.*, 925 F.2d 325 (9th Cir. 1991). The Ninth Circuit in *Brentwood* looked to how the actual transactions were conducted, and did not focus its analysis on what the customers of the bankrupt entity may have perceived. The Ninth Circuit disregarded the conduct of the third party which was not a debtor in the bankruptcy case and refused to allow the conduct of that entity to dictate the relationship of the debtor and the creditors of the estate. The *Brentwood* court refused the investors' efforts to blend the acts of two separate and distinct entities, and instead focused its analysis on how the transactions actually occurred.

Contrary to the holding in *Brentwood*, the Respondents want this court to look to the transactions whereby the Respondents deposited their funds with B&G to satisfy the first prong of the two-part stockbroker definition. The Respondents and the lower courts below then have looked to the conduct of Mutual Services, an unrelated entity who has no relationship whatsoever with the Respondents, to enable the Respondents to satisfy the second prong of the stockbroker test. If the same rationale which was applied in *Brentwood* is applied in the present case, a stockbroker

liquidation is clearly unwarranted.

The Respondents have also cited the case of *In re Gibralco, Inc.*, 53 B.R. 324 (Bankr. C.D. Calif. 1985) as authority that defrauded customers should be given a preference over general creditors. However, *Gibralco* is easily distinguishable from the present action since the debtor in that case was a fully licensed and operating bond brokerage firm. The investors in *Gibralco* would provide funds directly to the brokerage firm to be held in their accounts. However, an employee of the brokerage firm instead diverted the funds into a separate account under the employee's control. When the broker became insolvent, the defrauded investors asserted their priority.

Gibralco is a perfect example of how the stockbroker liquidation provisions are meant to apply when a brokerage firm becomes insolvent. However, *Gibralco* does not provide support for the proposition that B&G should be liquidated under the stockbroker liquidation provisions for the purpose of benefitting defrauded investors.

Clearly, Congress never intended for the stockbroker liquidation provisions to be applied where the debtor never engaged in securities transactions and as a result, never held any securities. It is not the province of a court to convert a criminal Ponzi enterprise into a stockbroker for the purpose of giving a priority to defrauded investors. The more reasoned approach is an approach similar to that taken by the Fifth Circuit in *Wider v. Wooton*, 907 F. 2d 570 (5th Cir. 1990) and the Ninth Circuit in *Graulty v. Brooks* (*In re Bishop, Baldwin, Rewald, Dillingham and Wong, Inc.*), 819 F.2d 214 (9th Cir. 1987). Both of these circuits have concluded that Congress did not intend to easily condone the activities of a fraudulent Ponzi scheme, and both have concluded that in a Ponzi scheme, creditors should generally share equally in whatever assets are available. The lower courts in this action, however have placed themselves at odds

with these decisions by judicially condoning the activities of a Ponzi scheme to benefit one set of creditors over another. Clearly, compelling reasons are present in this case to justify granting WesBanco's Petition.

Respectfully submitted,

/S/_____

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